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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1966

No. 565

BARBARA L. HIATT,
Petitioner,

vs.

SAN FRANCISCO NATIONAL BANK, and FEDERAL DEPOSIT INSURANCE CORPORATION, as Receiver of San Francisco National Bank,
Respondents.

BRIEF OF RESPONDENTS IN OPPOSITION TO PETITION FOR CERTIORARI

QUESTION PRESENTED

We believe that the question presented can best be stated as follows: *Whether interest exceeding 10 per cent is allowed by California law to banks and therefore is permitted by 12 U.S.C. § 85.*

STATEMENT OF THE CASE

Because we think petitioner's statement of the case is defective in several respects, we respectfully submit our own statement, as follows.

The federal usury law, which is contained in 12 U.S.C. § 85, provides:

> "Any association (i.e. national banking association) may . . . charge . . . interest at the rate allowed by the laws of the State . . . where the bank is located . . . and no more, except that where by the laws of any State a different rate is limited for banks organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under this chapter. When no rate is fixed by the laws of the State . . . the bank may . . . charge a rate not exceeding 7 per centum . . ."[1]

The relevant California law is contained in Sec. 22 of Article XX of the constitution, which was adopted in 1934 and which provides:

> "The rate of interest upon the loan . . . of any money . . . shall be 7 percent per annum but it shall be competent for the parties to any loan . . . to contract in writing for a rate of interest not exceeding 10 percent per annum.
>
> No person . . . shall by charging any fee, bonus, commission, discount or other compensation receive from a borrower more than 10 percent per annum upon any loan . . .

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[1]Section 86 of the statute provides for forfeiture of interest exceeding the rate allowed by Sec. 85 and for recovery of twice the amount thus paid.

However, none of the above restrictions shall apply to . . . *any bank created and operating under and pursuant to any laws of this State or of the United States of America* . . .

* * * * * * *

The Legislature[2] may from time to time prescribe the maximum rate per annum of . . . the fees, bonus, commissions, discounts or other compensation which all or any of the said exempted classes of persons may charge or receive from a borrower in connection with any loan . . .

The provisions of this section shall supersede all provisions of this Constitution and laws enacted thereunder in conflict therewith." (Emphasis supplied.)

The District Court in the case at bar, acting through Judge William T. Sweigert, held that the interest rate here involved did not violate the federal usury law, the reason being that since the California law exempted certain specified organizations, including banks, state and national, from all restrictions on interest, the rate here involved was "allowed by the laws of the State."

And the Court of Appeals affirmed on the same ground, saying:

"Our conclusion must necessarily be that the language of 12 U.S.C. § 85 which reads 'Any association may . . . charge . . . interest at the

[2]Since the California legislature has not acted on this subject with respect to banks, the law in that regard remains as stated in the constitution, and banks are subject to no restriction on interest rates. *Carter v. Seaboard Finance Co.*, 33 Cal.2d 564, 203 P.2d 758 (1949).

> rate allowed by the laws of the state . . . where the bank is located . . .' should be construed as meaning that a national association located in a particular state may charge as much interest as may be legally charged by the state's banks under the state's existing law." (Transcript of Record, page 49.)

Petitioner argues against this. She contends, contrary to the clear language of the statute, that Congress intended to allow national banks to charge the rate of interest allowed by the laws of the state *only* when the state law "specifically fixes and limits" a rate of interest.[3] As a consequence, according to petitioner, national banks are restricted to the 10% maximum fixed rate allowed under California law for lenders generally although state banks are *allowed* to charge any rate of interest by virtue of their exemption.[4]

If petitioner's contention were to prevail, the result would be that while state banks in California may charge any rate of interest, national banks would be limited to the 10 per cent which persons other than state banks may charge. In other words, petitioner is attributing to Congress the intention to place national banks at a disadvantage compared with state banks in this respect. We respectfully submit that this is an erroneous interpretation of the statute, and that the Courts below were correct in holding the contrary.

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[3]Petition, pp. 8, 9.

[4]Petition, pp. 8, 9; Question No. 2, pp. 3, 4.

ARGUMENT

I

PURPOSE OF THE FEDERAL STATUTE, AND RULE OF CONSTRUCTION

In construing this statute, this Court in *Tiffany v. Bank of Missouri,* 85 U.S. (18 Wall.) 409, 410 (1874), said:

> "In an action like the present, brought to recover that which is substantially a statutory penalty, the statute must receive a strict, that is, a literal construction. The defendant is not to be subjected to a penalty unless the words of the statute plainly impose it."

The Court in *Tiffany* also spoke of the purpose of the statute. In that respect, it said, at page 412:

> "It cannot be doubted, in view of the purpose of Congress in providing for the organization of national banking associations, that it was intended to give them a firm footing in the different states where they might be located. It was expected they would come into competition with state banks, and it was intended to give them at least equal advantages in such competition. In order to accomplish this they were empowered to reserve interest at the same rates, whatever those rates might be, which were allowed to similar state institutions. This was considered indispensable to protect them against possible unfriendly state legislation. Obviously, if state statutes should allow to their banks of issue a rate of interest greater than the ordinary rate allowed to natural persons, national banking associations could not compete with them, unless allowed the same."

II

THE STATUTE SHOULD BE CONSTRUED AS PERMITTING THE INTEREST CHARGED IN THIS CASE

The California law provides in effect that both state and national banks may charge any rate of interest. It does this by setting a maximum rate of 10 per cent for persons generally and then providing that certain enumerated organizations, including state and national banks, are exempt from that restriction. Thus the California law "allows" a national bank to charge any rate. And the federal usury statute provides that a national bank may charge interest "at the rate allowed by the laws of the State . . .". The conclusion is that the federal usury law does not subject national banks to a restriction of interest in California.

III

PETITIONER'S ARGUMENTS

Petitioner presents her arguments under four headings, which we now consider.

A. Interpretation of a Federal Statute

Petitioner argues that by the usury statute Congress intended that the interest rates chargeable by national banks be subjected to limitations of "a specific, fixed amount."

The statute does not evince any such limitation of intent. It says "at the rate allowed by the laws of the state." And, as this Court held in *Tiffany,* the

purpose is to put national banks on an equal footing with state banks.

Besides, petitioner's contention is disposed of by the decision in *Daggs v. Phoenix National Bank,* 177 U.S. 549, 554, 555 (1900). That case involved an Arizona statute which provided that the parties may agree to any rate of interest. This Court said:

> "The contention of appellant is that the rate of interest is not *fixed* by the laws of the territory. It permits the parties to do so, but does not do so itself. In other words, it is urged that the rate is fixed by permission of the laws, and not by the laws, and upon this distinction a power which every person and every bank in the territory has, it is contended, the national banks do not have.
>
> We cannot accept this as a correct interpretation of either the spirit or the words of the national banking act. By that act, certainly no discrimination was intended against national banks, and that the interpretation contended for would seriously embarrass their business is manifest." (Emphasis the Court's.)

After quoting from *Tiffany* to the effect that Congress did not intend to expose national banks to unfair treatment by the states, the Court in *Daggs* quoted the federal statute, and then said, at page 555:

> "The meaning of these provisions is unmistakable. A national bank may charge interest at the rate *allowed* by the laws of the state or territory where it is located; and equality is carefully secured with local banks.

> The clear meaning and purpose of these provisions remove the ambiguity of those which follow, if there is any ambiguity. 'When no rate is *fixed* by the laws of the state or territory or district, the bank may take, receive, or charge a rate not exceeding 7 per centum.' '*Fixed by the laws*' must be construed to mean '*allowed by the laws,*' not a rate expressed in the laws. In instances it might be that, but not necessarily. The intention of national law is to adopt the state law, and permit to national banks what the state law allows to its citizens and to the banks organized by it. *Tiffany v. National Bank,* 18 Wall. 409, 21 L.ed. 862." (Emphasis the Court's.)

Petitioner argues that § 86 (the remedial section) was enacted for the victims, not the perpetrators, of usury, and that the decision in the case at bar renders § 86 "mere surplusage." This is erroneous. § 86 remains effective in all cases in which § 85 is violated. The issue here is § 85, not § 86.

Petitioner refers to the fact that § 85 contains alternative provisions. The section says that a bank may charge interest "at the rate allowed by the laws of the State . . . *or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located,* whichever may be the greater, and no more . . .". Petitioner refers to the part which we have italicized and says that the necessity of a specific rate is confirmed by that part. We respectfully disagree. The alternative provision could be applicable in cases where the state law would set a specific maximum rate which would be

applicable to banks; it is simply irrelevant where the state law prescribes no limit. It is significant that the point is not even mentioned in *Daggs*.

B. Petitioner's Contention of Conflict Between Circuits

Petitioner argues that there is a conflict with the decision of the second circuit in the year 1873 in *In re Wild*, 29 Fed.Cas. 1211. That case involved a New York statute which provided that a corporation could not assert the defense of usury. The Court said that the effect of that was that there was no law in New York fixing the rate of interest on loans to a corporation and accordingly it applied the 7 per cent limitation contained in the federal statute.

Whether the situation in *Wild* is identifiable in legal effect with that in the present case is a question, but even if it were deemed to be so, we think that the conclusions of the Circuit Court in *Wild* are superseded by those of this Court in the *Daggs* case, and therefore, the status of *Wild* as a precedent has long since been removed.

Petitioner says that the *Wild* case has not been criticized. This is erroneous. In *Penrose v. Canton National Bank*, 147 Maryland 200, 127 Atl. 852 (1925), the statute involved was like that in the *Wild* case. It provided,

> "No corporation shall hereafter interpose the defense of usury in any action at law or in equity."

In dealing with this subject, the Court in the *Penrose* case said (127 Atl. at page 856):

"We have found little authority directly on the question of the applicability of this statute to loans by national banks. In two cases, In re Wild, Fed. Cas. No. 17,645, 11 Blatchf. 243, and Bramhall v. Atlantic National Bank, 36 N.J. Law, 243; 248, it was held that the abolition of the defense on a corporation note did not relieve a national bank from forfeiture of interest, or the penalty, for exceeding the limit of 7 per cent. specified in the federal law. Those courts considered the legal situation to be as if the state laws had omitted to fix any rate for such loans within the meaning of the federal law, so that the 7 per cent. limit specified in the latter law for states in which the laws have not fixed a rate would apply. But it seems to us that in view of the fact that the obvious purpose of the state statute is to leave lenders and corporate borrowers free to agree upon any rate of interest above the regular limit, the construction of the case of In re Wild and Atlantic Nat. Bank, supra, is inconsistent with the purpose of the federal law, declared in many decisions of the Supreme Court (Tiffany v. Nat. Bank of Missouri, 18 Wall. 409, 21 L. Ed. 862), *to put national banks in a position of equality with state institutions for dealing in loans.* Following out that purpose, it has generally been held *in later cases* that in those states in which statutes permit parties to loans to agree upon interest beyond the regular limits, *national banks must be held permitted to do the same thing.* (Citations)" (Emphasis added.)

Petitioner says that the *Wild* decision is not affected by the *Daggs* because the New York statute is distinguishable from the Arizona statute. On the contrary,

on a loan to a corporation, the laws of the two states were in effect the same, that is, the parties could contract freely as to interest. Moreover, the effectiveness of the *Daggs* decision in the case at bar is impliedly recognized by petitioner herein, who says that "*Daggs* was incorrectly decided." We believe, on the contrary, that the reasoning of the Court in the *Daggs* case was reasonable and correct and logically carries out the rule of construction and policy expressed in the *Tiffany* case.

Petitioner points out that the California law adopted in 1850 was the same as the Arizona statute (providing that parties could agree on any rate) but that the California law was repealed in 1919, and the California constitutional amendment of 1934 now governs. If this is an effort to escape the effect of *Daggs,* it is ineffective, because the Arizona statute and the California constitution amount to the same thing, namely that parties are free to agree on a rate of interest.

C. Petitioner's Contention That the Decision Herein Conflicts With a Decision of the California Supreme Court

The California Supreme Court in *Carter v. Seaboard Finance Co.,* 33 Cal.2d 564, 203 P.2d 758 (1949), said that until the legislature exercises the power granted to it by the constitutional amendment to regulate the business of lenders in a manner appropriate to each exempted class, the class not so governed by legislation is subject to no restriction on interest rates. Petitioner states that nevertheless the Court below in the present case construed the California law exempt-

ing banks from interest rates as having "fixed" the rates for state banks.

There is no conflict whatsoever with the California decision in the *Carter* case. In calling exemption from an interest rate a "fixing" of a rate, the Court here, as in *Daggs,* was construing a *federal* statute.

D. Petitioner's Charges Against National Banks

Petitioner's counsel closes his argument by making charges against national banks which are based upon assumptions, for which he goes outside the record.

He says that the assets of national banks in California amount to 29 billions of dollars, and that he hopes that the action of this Court will prevent "the unlimited gouging of California citizens, at least by national banks."

Of the bank here in receivership, he says there are numerous borrowers who are in litigation with the bank and "presumably" the disposition of their cases will be affected by the decision in this case; that he "does not know but has reason to think" that these cases involve millions of dollars; that undoubtedly we could supply the Court with the total amount involved but that we declined to inform petitioner's counsel thereof. Our reason for declining to furnish the requested information was that the subject matter thereof lies outside the record in this case; and for that reason, we respectfully submit that it has no place in the argument of the petition.

CONCLUSION

The interest charged in this case was allowable by local law. Therefore, it is permitted by the federal usury statute.

We respectfully submit, therefore, that the petition should be denied.

Dated, San Francisco, California,
October 14, 1966.

Respectfully submitted,
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